

Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations,
Title 18, Section 1533.2, *Diesel Fuel Used in Farming Activities or Food*
Processing

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND ANTICIPATED BENEFIT

Current Law

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code (RTC), § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

When sales tax does not apply, California use tax generally applies to the use of tangible personal property purchased from a retailer for storage, use or other consumption in California. (RTC, §§ 6011, 6201.) Unless an exemption or exclusion applies, the use tax is measured by the sales price of tangible personal property and the person actually storing, using, or otherwise consuming the tangible personal property is liable for the tax. (RTC, §§ 6011, 6201, 6202, 6401; Cal. Code Regs., tit. 18, § 1685.) However, every retailer "engaged in business" in California that makes sales subject to California use tax is required to collect the use tax from its customers and remit it to the State Board of Equalization (Board), and such retailers are liable for California use tax that they fail to collect from their customers and remit to the Board. (RTC, § 6203; Cal. Code Regs., tit. 18, § 1684.)

In 2002, the Board adopted California Code of Regulations, title 18, section (Regulation) 1533.2, *Diesel Fuel Used in Farming Activities and Food Processing*, to implement, interpret, and make specific the provisions of RTC section 6357.1, which provides a partial exemption from sales and use tax for sales and purchases of "diesel fuel" for use in farming activities or food processing, but does not define the term "diesel fuel." Regulation 1533.2 clarifies the conditions under which a sale or use of diesel fuel qualifies for the partial exemption provided by RTC section 6357.1. Also, as relevant here, Regulation 1533.2 provides a definition for the term "diesel fuel" solely for purposes of the partial exemption provided by RTC section 6357.1, which is based in part on the definition of "diesel fuel" adopted by the California Air Resources Board (ARB) and codified in California Code of Regulations, title 13, section (ARB Regulation) 2281, *Sulfur Content of Diesel Fuel*, at the time Regulation 1533.2 was adopted. Regulation 1533.2, subdivision (b)(6), currently specifies that:

"Diesel fuel" means, for purposes of this regulation only, any fuel that is commonly or commercially known, sold or represented as diesel fuel No. 1-D or No. 2-D, pursuant to the specifications in American Society for Testing and

Materials Standard Specification for Diesel Fuel Oils (“ASTM”) D 975-81, which is incorporated herein by reference. Diesel fuel, for purposes of this regulation only, also includes Environmental Protection Agency rated diesel fuel commonly known as “federal fuel” sold for use in locomotives, or which is used in generators, pumps, dehydrators and any other equipment used in the conduct of farming and food processing activities. “Diesel fuel” does not include gasoline, kerosene, liquefied petroleum gas, natural gas in liquid or gaseous form, alcohol, aviation fuel, except diesel fuel sold for use in aircraft designed for agricultural aerial applications that meets the specifications of ASTM D 1655, jet fuel, bunker fuel, or other like substance used as a fuel. Qualifying diesel fuel shall be identified accordingly on the invoice of sale.

In 2004, the ARB made substantive amendments to the definition of “diesel fuel” in ARB Regulation 2281, subdivision (b)(1), and the following text reflects the 2004 amendments using “strikeout” and “underline” format:

“Diesel fuel” means any fuel that is commonly or commercially known, sold or represented as diesel fuel ~~No. 1-D or No. 2-D, pursuant to the specifications in ASTM Standard Specification for Diesel Fuel Oils D975-81, which is incorporated herein by reference,~~ including any mixture of primarily liquid hydrocarbons – organic compounds consisting exclusively of the elements carbon and hydrogen – that is sold or represented as suitable for use in an internal combustion, compression-ignition engine.

The ARB’s Final Statement of Reasons (June 2004) for the amendments to Regulation 2281, subdivision (b)(1), explains that:

The amendments to the definitions of diesel fuel [were] intended to clarify the broad applicability of the sulfur and aromatic hydrocarbon standards to fuels that are burned in diesel engines and are primarily hydrocarbons. Under the amendments, a fuel that is sold or represented as suitable for use in internal combustion, compression-ignition (diesel) engines, and is a blend of more than 50 percent by volume hydrocarbon fuel with some other non-hydrocarbon component or components, is subject to the sulfur and aromatic hydrocarbon standards.

The current regulations define “diesel fuel” as “any fuel that is commonly or commercially known, sold or represented as diesel fuel No. 1-D or No. 2-D, pursuant to the specifications in ASTM Standard Specification for Diesel Fuel Oils D 975-81.” There have been instances where parties have marketed products characterized as kerosene or “Jet A” to consumers of diesel fuel for use in vehicular diesel engines, and have claimed that the fuel is not subject to the sulfur and aromatic hydrocarbon content standards because the fuel does not – or has not been represented as – meeting the ASTM D 975-81 specifications. It has been the position of ARB counsel that the sale or supply of a fuel in these circumstances is subject to the standards as long as the fuel is a petroleum distillate that is suitable

for use in the vehicular diesel engines for which the common grades No. 1-D or 2-D are specified. Similarly, if a vendor is explicitly or implicitly offering a fuel as suitable for use in those engines, it meets the definition of diesel fuel. This includes circumstances in which the vendor of a petroleum distillate knows or reasonably should know that the fuel being provided will be used by the customer as a fuel for diesel engines in motor vehicles. The amendments remove any ambiguity that might exist regarding the applicability of the sulfur and aromatics regulations.

RTC section 60022 defines the term “diesel fuel” for purposes of the Diesel Fuel Tax Law (RTC, § 60001 et seq.), which is also administered by the Board. RTC section 60022, subdivision (a), currently provides that:

“Diesel fuel” means any liquid that is commonly or commercially known or sold as a fuel that is suitable for use in a diesel-powered highway vehicle. A liquid meets this requirement if, without further processing or blending, the liquid has practical and commercial fitness for use in the engine of a diesel-powered highway vehicle.

However, a liquid does not possess this practical and commercial fitness solely by reason of its possible or rare use as a fuel in the engine of a diesel-powered highway vehicle.

“Diesel fuel” does not include kerosene, gasoline, liquefied petroleum gas, natural gas in liquid or gaseous form, or alcohol.

Biodiesel is expressly included in the definition of diesel fuel in RTC section 60022 and Board staff has historically considered biodiesel to be diesel fuel that can qualify for the partial sales and use tax exemption for diesel fuel used in farming activities and food processing under RTC section 6357.1.

Furthermore, the exemption provided by RTC section 6357.1 is referred to as a partial exemption because section 6357.1, subdivision (c), provides that the exemption for diesel fuel used in farming activities and food processing does not apply to specified sales and use taxes included in the statewide sales and use tax rate. Also, Regulation 1533.2, subdivision (c), prescribes the content of the partial exemption certificate that purchasers are required to provide to retailers to claim the partial exemption provided by RTC section 6357.1. Subdivision (c) provides that any document satisfying the requirements may be used as an exemption certificate, and Appendix A to Regulation 1533.1 provides a partial exemption certificate form. And, as relevant here, the note section in Appendix A provides that the exemption provided by RTC section 6357.1 “is an exemption only from the state general fund portion of the sales and use tax rate” because that was the case when the Board adopted Regulation 1533.2. However, the partial exemption provided by RTC section 6357.1 now applies to state sales and use taxes that are not required to be deposited in the general fund, such as the sales and use tax imposed by section 36 of article XIII of the California Constitution that goes to the state’s Education Protection Account (as already provided in Regulation 1533.2, subdivision (a)).

Proposed Amendments

Need for Consistency

The 2004 amendments to ARB Regulation 2281, subdivision (b), created an issue (or problem within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)). This is because the definition of diesel fuel in Regulation 1533.2, which refers to the American Society for Testing and Materials Standard Specification for Diesel Fuel Oils (“ASTM”) D 975-81, is no longer consistent with the provisions of ARB Regulation 2281, subdivision (b)(1), which no longer refer to the “ASTM Standard Specification for Diesel Fuel Oils D975-81.” Therefore, Board staff considered whether it was necessary to amend the definition of diesel fuel in Regulation 1533.2 due to the 2004 amendments to the definition of diesel fuel in ARB Regulation 2281. And, staff found that, for purposes of the administering the partial exemption provided by RTC section 6357.1, it would be more effective to amend the definition of diesel fuel in Regulation 1533.2 so that the definition will no longer be based upon the ARB definition, but instead will be based upon the definition of the term diesel fuel contained in section 60022 of the Diesel Fuel Tax Law. This is because staff determined that revising the definition of diesel fuel so that it is consistent in the sales and use tax regulations and the Diesel Fuel Tax Law will provide more clarity to taxpayers and staff.

Interested Parties Process

The Board’s Business Taxes Committee (BTC) staff prepared draft amendments to subdivision (b)(6) of Regulation 1533.2 to revise the definition of diesel fuel to be consistent with the definition of diesel fuel in RTC section 60022. BTC staff subsequently prepared a discussion paper, and provided the discussion paper and proposed amendments to the interested parties. On July 15, 2014, BTC staff conducted an interested parties meeting to discuss the draft amendments.

Since BTC staff did not receive any inquiries or written comments regarding its draft amendments during or subsequent to the July 15, 2014, interested parties meeting and staff had no changes to its recommendation to amend Regulation 1533.2, BTC staff did not prepare a second discussion paper and cancelled the second interested parties meeting that was previously scheduled to discuss staff’s draft amendments. Staff also notified interested parties that comments could be submitted up to September 25, 2014, for consideration in the preparation of the Formal Issue Paper regarding the draft amendments. However, staff did not receive any other comments.

November 19, 2014, BTC Meeting

Subsequently, staff prepared Formal Issue Paper 14-009 and distributed it to the Board Members for consideration at the Board’s November 19, 2014, BTC meeting. Formal Issue Paper 14-009 recommended that the Board approve and authorize publication of the amendments to Regulation 1533.2 (discussed above) in order to revise the definition of the term diesel fuel in Regulation 1533.2, subdivision (b)(6), so that the term has the same meaning as defined in section 60022 of

the Diesel Fuel Tax Law. Formal Issue Paper 14-009 recommended that the Board add language to Regulation 1533.2, subdivision (b)(1), Example B, to provide a complete, grammatically correct sentence and to clarify which specific trips qualify for the partial exemption, and to remove the reference to the “general fund” in the note section of Appendix A to Regulation 1533.2. Formal Issue Paper 14-009 also recommended that the Board replace the capital “S” with a lower case “s” at the beginnings of the words “Section” throughout Appendix A to Regulation 1533.2 to make the words consistent with the references to “section” and “sections” in the body of the regulation and consistent with the citation format prescribed in the California Style Manual.

During the November 19, 2014, meeting, the Board Members unanimously voted to propose the amendments to Regulation 1533.2 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1533.2 are reasonably necessary for the specific purpose of addressing the issue (or problem) created by the 2004 amendments to ARB Regulation 2281 by making the definition of diesel fuel in Regulations 1533.2 consistent with the definition of the diesel fuel in the Diesel Fuel Tax Law because making the definition of diesel fuel consistent in the sales and use tax regulations and the Diesel Fuel Tax Law will provide more clarity to taxpayers and staff.¹

The Board anticipates that the proposed amendments to Regulation 1533.2 will reduce confusion, promote fairness, and benefit retailers, consumers, Board staff, and the Board by making the definition for the term diesel fuel in Regulation 1533.2 consistent with the definition for the term diesel fuel in the Diesel Fuel Tax Law that applies to diesel fuel transactions, and clarifying that biodiesel is diesel fuel for purposes of the partial exemption from sales and use tax for diesel fuel used in farming activities or food processing.

In addition, the Board has determined that the proposed amendments are not mandated by federal law or regulations, and there are no federal regulations or statutes that are identical to Regulation 1533.2 or the proposed amendments to Regulation 1533.2.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-009, the exhibits to the issue paper, and the comments made during the Board’s discussion of the issue paper during its November 19, 2014, BTC meeting in deciding to propose the amendments to Regulation 1533.2 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1533.2 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed

¹ After the November 19, 2014, BTC meeting, Board staff noticed that a comma should have been inserted after the first reference to “2013” in the current text of Regulation 1533.2, subdivision (a)(3), and the inadvertently omitted comma is now included in the text of the proposed amendments to Regulation 1533.2, to make subdivision (a)(3) grammatically correct.

amendments to Regulation 1533.2 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1533.2 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

**INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2,
SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY
GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

The proposed amendments make the definition for the term diesel fuel in Regulation 1533.2 consistent with the definition for the term diesel fuel in the Diesel Fuel Tax Law, the proposed amendments do not mandate that individuals or businesses do anything that is not already required by the Sales and Use Tax Law, and there is nothing in the proposed amendments that would significantly change how individuals and businesses would generally behave, in the absence of the proposed regulatory action, or that would impact revenue. Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and businesses. And, the Board has determined that the proposed amendments to Regulation 1533.2 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period.

Further, based on these facts and all of the information in the rulemaking file, the Board has also determined that the adoption of the proposed amendments to Regulation 1533.2 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1533.2 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1533.2 will not affect the benefits of Regulation 1533.2 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1533.2 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1533.2 may affect small businesses.